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Before the
FEDERAL COMMUNICATIONS COMMISSION
Washington, D.C. 20554

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FEDERAL COMMUNICATIONS COMMISSION
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In the Matter of	)	
	)	
Implementation of the Pay Telephone Reclassification and Compensation Provisions of the Telecommunications Act of 1996	)	Case No. 96-128

REPLY COMMENTS OF THE AMERICAN PUBLIC COMMUNICATIONS COUNCIL

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SUMMARY

The Commission should continue to rely on a market-based approach to dial-around compensation ("DAC"). The Commission clearly adopted a market-based approach in the Payphone Orders, IXC protestations to the contrary notwithstanding. Nothing the court of appeals did requires the Commission to depart from this approach. The court did not disapprove the Commission's conclusion that market-based rates for per call DAC are preferable to cost-based rates. Market based-surrogates are fully consistent with Section 276 and with established law.

The PSPs have established that a market-based approach is the correct course. The PSPs have shown that market surrogates support a per call rate equal to $.35 or more. The market-based approach accounts for the relatively small cost differences that concerned the court of appeals.

The Commission properly rejected the marginal cost approaches now readvocated by the IXCs. The Commission should not and cannot establish compensation to cover only the costs of the "additional keypad wear and tear." The record shows that a reasonable level of DAC is necessary to achieve reasonable rates of return for PSPs. By continuing to rely on a market-based approach, the Commission can ensure that the per call DAC will adjust to a level that ensures fair compensation with no windfalls to PSPs.

The IXCs also argue that no costs related to coin calling should be covered by DAC. Although no longer calling their approach a "TELRIC" or "TSLRIC" approach,

they in essence make the same arguments that fixed costs of providing coin calling must also be excluded form DAC. This analysis, best illustrated by AT&T's arguments, is conceptually and methodologically flawed and contains numerous factual and other errors as well. AT&T's analysis is conceptually flawed because there would be virtually no payphones without coin calling, and therefore the costs of coin calling are properly included in DAC. But even using AT&T's approach of including no coin calling costs, once AT&T's numerous methodological errors, omissions, and factual errors are accounted for, the cost of a coinless call is $.57.

The "bellwether" approach to setting per call DAC is also unacceptable. Certainly the deeply flawed, second hand, quickly prepared NYNEX study -- designed to get NYNEX through the transition from regulation to deregulation, prepared with an eye toward gaining a temporary rate increase but avoiding permanent rate reductions that would result if the true subsidy were shown, skewed by regulatory considerations, reflecting only one state, and not being a study with deregulated, tariffed rates being imputed -- cannot serve as the bellwether under Commission precedent. If there is to be a "bellwether," it must be one of the large, nationwide, or at least region-wide, companies paying tariffed rates that forms the baseline. For these companies, average costs per call are at about $.40.

Even if a cost based approach is used, the costs of screening digits must not be included. These costs are properly absorbed by the LECs since the allocation of screening digits by the LECs is entirely arbitrary. There is no reason any one class of ratepayer should bear these costs when the LECs can arbitrarily control who pays it by the manner in which they allocate the screening digits. Independent PSPs have already overpayed for the near useless "07" screening digit for well over a decade.

The Commission should retain flat rate interim compensation. Congress clearly did not intend for PSPs to go uncompensated for any period of time.

Further the IXCs have been recovering -- indeed over-recovering -- the cost of DAC during most of the period it has been in effect. In setting their rates to recover the cost of DAC, the IXCs apparently did not take account of the hundreds of millions of dollars they have saved by having payphone costs removed form regulated accounts.

The paging industry's attempt to reargue "carrier pays" are without merit. Blocking is feasible once a data base of payphone ANIs is developed, which should easily occur before per call DAC is tied to an individual provider's price. Nor need the Commission abandon individually set DAC rates in favor of a uniform rate.

Before the
FEDERAL COMMUNICATIONS COMMISSION
Washington, D.C. 20554

In the Matter of Implementation of the Pay Telephone Reclassification and Compensation Provisions of the Telecommunications Act of 1996	)	Case No. 96-128

REPLY COMMENTS OF THE
AMERICAN PUBLIC COMMUNICATIONS COUNCIL

The American Public Communications Council ("APCC") hereby replies to comments submitted in response to the Commission's Public Notice, DA 97-1673, released August 5, 1997, requesting comment on the remand issues in this proceeding arising from the court of appeals decision in Illinois Public Telecommunications Ass'n v. FCC, No. 96-1394, slip op. (D.C. Cir., July 1, 1997) ("IPTA").

I. DIAL-AROUND COMPENSATION LEVEL

The IXCs' comments are based on the premises that (1) the Commission must prescribe "dial-around"[1] compensation based on "PSPs' actual costs in originating

[1] In these reply comments, APCC uses the term "dial-around" to refer to any call that meets the criteria for "default" compensation under the FCC's rules adopted in this proceeding, i.e., any completed call for which the PSP does not charge the end user, and for which there is no compensation agreement between the PSP and the carrier. See Implementation of the Pay Telephone Reclassification and Compensation Provisions of the Telecommunications Act of 1996, CC Docket No. 96-128, Report and Order, 11 FCC Rcd 20541 (1996) ("Payphone Order"), Appendix E, § 64.1300; Order on
(Footnote continued)

compensable coinless calls" (AT&T at 3), and may not rely on market-based surrogates; and (2) that the relevant costs cannot include any costs related to coin calling. As discussed below, neither premise is valid.

A. The Commission Can And Should Employ A Market-Based Approach To Dial-Around Compensation

In asserting that compensation must be solely or primarily cost-based, various IXCs characterize the FCC's 1996 orders in different and mutually inconsistent ways. According to some IXCs, the Commission itself, in its 1996 orders, ruled dial-around compensation must be *cost-based.* Cable & Wireless at 6; Comptel at 11; LCI at 4, n.10; Sprint at 2-3. These IXCs contend that, because the Commission's earlier orders espoused a "cost-based" approach, the Commission is now precluded from applying a market-based approach.[2] According to AT&T, by contrast, the Commission's 1996 orders ruled that *market-based* rates should govern, and the Court corrected the FCC by requiring cost-based rates. AT&T at 3-4. Neither of these inconsistent positions can be supported.

(Footnote continued)
Reconsideration, FCC 96-439, released November 8, 1996 ("Reconsideration Order"). Thus, "dial-around" calls include, but are not necessarily limited to, "access code" calls and "subscriber 800" calls.

2 It is odd that the IXCs argue this, since many of them also argue that the compensation provisions of the earlier orders, which they allege adopted a cost-based methodology, have been vacated by the court of appeals. See Section II, below.

1. The Payphone Orders Adopted a Market-Based Approach to Dial-Around Compensation

The IXCs' claim that the Commission has embraced a cost-based rather than market-based approach to dial-around compensation is simply wrong. In the Payphone Order, the Commission repeatedly stated that a market-based approach is superior to a cost-based approach in setting compensation for *all* payphone calls:

> We conclude that, once competitive market conditions exist, the most appropriate way to ensure that PSPs receive fair compensation for *each call* is to let the market set the price for individual calls originated on payphones.
>
> * * *
>
> In keeping with our long-term goal to have the market set the compensation amount, we define "fair compensation" above as where there is a willing seller and a willing buyer at a price agreeable to both.
>
> * * *
>
> Once competitive conditions exist, we believe that the market should set the compensation amount for *all* payphone calls, including local coin calls. . . . We believe this approach is appropriate because, once PSPs are free to enter the market, and once callers are free to choose payphones for their calls, the market will ultimately determine whether a particular payphone is economically viable.
>
> * * *
>
> Because we have established elsewhere in this Report and Order that the payphone marketplace has low entry and exit barriers and will likely become increasingly competitive, we conclude that the market (or the states, where there are special circumstances) is best able to set the price for payphone calls in the long term. We conclude further that the appropriate per-call compensation amount ultimately is the amount the particular payphone charges for a local coin call, because the market will determine the fair compensation rate for those calls.
>
> * * *

> We conclude that the market-based rate in [four of five states that deregulated the local coin rate] is the best evidence of a per-call compensation amount that will fairly compensate PSPs.
>
> * * *
>
> We conclude that by making the per-call amount subject to negotiations, the marketplace will make the appropriate adjustments, whether upward or downward.

Payphone Order, ¶¶ 49, 52, 56, 70, 72, 73 (emphasis added). These passages make it crystal clear that, while the Commission's NPRM may have *tentatively concluded* otherwise, the Commission's Payphone Order moved away from the perspective initially advanced in the NPRM, and fully embraced a rate-setting approach for *all* payphone calls that is focused on market prices, not cost analysis.

The Commission made its approach even clearer in the Reconsideration Order, where it squarely rejected arguments that its compensation approach should be primarily cost-based.

> Although it could have directed us to adopt a particular methodology for determining fair compensation, *Congress did not mandate a cost-based standard* for compensation in Section 276, as it did in Section 251. . . . We also reject suggestions that use of a market-based compensation standard, in lieu of one that is cost based, will overcompensate PSPs. The marketplace will ensure, over time, that PSPs are not overcompensated. . . . Finally, we believe that a cost-based compensation standard could lead to a reduction in payphones by limiting a PSP's recovery of its costs, and this result would be at odds with the legislative purpose of Section 276 that we "promote the widespread deployment of payphone services to the benefit of the general public."
>
> * * *
>
> Second, we conclude that Congress's use of the phrase ". . . payphone service providers are fairly compensated for each and every completed

> interstate and intrastate call . . . " is a different standard than the cost based standard articulated for the compensation for interconnection and unbundled elements. We conclude that the PSP will be providing a competitive service (payphone use) and should therefore receive compensation equal to the market-determined rate for providing this service. As we noted in the Report and Order, the market, as it becomes competitive, should generate a fair market-determined compensation rate. . . . In the case of payphones, the presence of multiple PSPs already operating in many markets, and the structure of the industry that allows relatively easy entry and exit, leads us to conclude that we can rely on market forces to provide for efficient pricing of these services in the near future.

Reconsideration Order, ¶¶ 66, 68 (emphasis added). It could not be clearer that in setting dial-around compensation, the Commission employed a "market-based compensation standard in lieu of one that is cost-based."[3]

2. The court of appeals did not require the FCC to abandon a market-based approach

AT&T is equally incorrect when it argues that the court of appeals rejected any reliance on market-based standards and required the FCC to use a cost-based standard. The court specifically held that "it was not unreasonable for the Commission to conclude that market forces generally will keep prices at a reasonable level". IPTA at 12. The Court *only* objected to the FCC's attempt to compare the *costs* of dial-around calls and local coin calls. Id. at 14-15.[4]

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[3] However, even if MCI and Sprint were correct, and the Commission had adopted a cost-based standard, the Commission would not be precluded from reconsidering this decision on remand.

[4] The court's opinion did not deny that the Commission's specific justification for prescribing a market-based rate to dial-around compensation was developed in the context of an overall approach that generally espoused market-based rates in lieu of cost-based rates. The court's opinion did not reject this overall approach. Far from it, the court (Footnote continued)

The Court in no way overruled the Commission's conclusion that market-based rates are preferable to cost-based rates in the payphone context. The Court only required the Commission, if it continues to rely on cost comparisons as a factor in the application of a market-based approach, to address the perceived defect in its rationale. As discussed in APCC's initial comments on remand, the court left the Commission free to (1) develop a different rationale for applying market-based rates, i.e., one that does not rely on similarity of costs,[5] or (2) adapt its previously chosen rationale to take account of ***all*** the relevant evidence as to the existence ***or non-existence*** of significant cost variations between dial-around calls and market-priced calls. APCC at 2-4. Either of these two alternatives can be accomplished without making radical changes in the Commission's overall approach. Either alternative would involve a less radical change in approach, and would better serve Congress's policy objectives, than the approach proposed by the IXCs -- which is essentially to abandon any reliance on market forces and to attempt to set the compensation level based on a highly technical (and deficient) "bottoms-up" analysis of payphone costs.

3. The use of market-based surrogates is fully consistent with Section 276 and applicable law

Contrary to the claims of some IXCs (Frontier at 3-4), the use of market-based surrogates is fully consistent with Section 276 and other applicable law. As the

(Footnote continued)
specifically affirmed the overall approach, as noted above.

5 See also Response of the Federal Communications Commission to Motion for Clarification or, Alternatively, for Partial Rehearing, filed in IPTA, August 22, 1997, at 10, n.9.

Commission itself pointed out in the Reconsideration Order, "Congress did not mandate a cost-based standard." Reconsideration Order, ¶ 66. The court of appeals did not indicate any disagreement with this conclusion. Furthermore, the use of market-based surrogates is well established. APCC Comments at 4, n.2.

4. The IXCs provide no other good reasons to abandon the market-based approach

Various IXCs claim that there are other reasons why the Commission should avoid or abandon reliance on market-based rates in setting the dial-around compensation rate. Several IXCs try to resurrect the claim that "locational monopolies" prevent the payphone market from being competitive. Frontier at 5-6; Midcom at 4-5; TRA at 17-19; Worldcom at 3-4. However, no new data are presented to make these claims any more plausible than they were when the Commission previously rejected them.[6] Midcom's theory that pre-existing contracts render a market noncompetitive is without merit. If Midcom's theory were correct, then the long-distance market and virtually every other telecommunications market would be non-competitive.[7]

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6 Frontier claims that 0+ commissions represent "monopoly rents..." because of the captive nature of the audience." Frontier at 5. Yet, on the very same page, Frontier notes the enactment of Section 226, to ensure that payphone callers are not a "captive audience." Calling data for 1996 indicate that dial-around calls (subscriber 800, access code and prepaid card calls) outnumber 0+ calls by more than 6 to 1. See APCC, Att. 4 (presenting calling data sharing 152 dial-around calls per payphone per month and 24 0+ calls per payphone per month).

7 To the extent that Midcom is saying the payphone market is *not yet fully* competitive, the Commission conceded this and, accordingly, allowed an interim compensation period before relying solely on market forces to set the compensation rate.

B. The Record Supports A Market-Based Dial-Around Rate Equal To Or Exceeding 35 Cents Per Call

The payphone industry's submissions in this proceeding demonstrate that market-based analysis is appropriate and leads to a dial-around compensation rate equal to or exceeding the current interim rate of 35 cents per call. By contrast, the "cost-based" submissions of the IXCs, which use unreliable data and which are riddled with conceptual and methodological flaws, cannot be relied on to support any reduction in the compensation rate. To the extent that the Commission seeks a cost-based rate, the cost submissions of APCC and independent PSPs are far more credible.

1. The payphone industry's approach is correct

The payphone industry parties have demonstrated that it is both reasonable and necessary for the Commission to set compensation based on market surrogates. In addition to local coin rates, the Commission can and should consider other market surrogates such as 0+ commissions. RBOC Coalition at 22-26. Market rates such as 0+ commissions and local coin calls can be reasonably analyzed in a variety of ways, any of which results in dial-around compensation rates that equal or exceed the local coin rate of 35 cents per call. See, e.g., APCC at 7-10 (weighted average of three market surrogates is roughly 45 cents per call). RBOC Coalition at 20-24 (inverse elasticity pricing analysis justifies a dial-around compensation rate of 42-43 cents per call); 24-26 (analysis of 0+ commission rates adjusted for the price of dial-around calls produces dial-around compensation rate range of 39-63 cents per call).

These market-based approaches -- or the Commission's original approach of setting dial-around compensation equal to the local coin rate -- are methodologically and legally sound. The problem identified by the court of appeals is resolved because the proposed market-based methods account for the relatively minor differences in the costs that are properly attributable to dial-around, 0+ and local coin calls. APCC at 6, n.5; 11-15; Communications Central at 6-13; RBOC Coalition at 15-20, 23. To the extent that the record of the 1996 proceeding appeared to indicate otherwise, it is primarily because IXCs incorrectly claimed that fixed costs such as line charges and equipment costs are attributable only to local coin calls and not to dial-around calls. As APCC and others have demonstrated in this remand proceeding, the relatively fixed costs of payphone equipment -- including coin calling capability, without which most payphones would never have been installed at their locations -- and most other categories of payphone costs are attributable to all categories of calls. Peoples at 6-7. Only certain variable cost categories -- local usage and collection costs -- are significantly different for coin and dial-around calls. The differences in these costs cut both ways, so that they essentially cancel each other out. Accordingly, any of the market-based approaches discussed above -- including the Commission's original approach of equating the dial-around rate to the local coin rate -- would be reasonable, and all are superior to the flawed "cost-based" methods advocated by the IXCs.

2. The IXCs' marginal cost arguments continue to be without merit

The IXCs' arguments that dial-around compensation cannot be higher than necessary to recover marginal or incremental cost are utterly without merit. This approach, described by Sprint as intended to limit recovery to "additional wear and tear on the handset and keypad" (Sprint at 4), was properly rejected by the Commission in 1996, and should be rejected again. The Commission said:

> We conclude that use of a purely incremental cost standard for all calls could leave PSPs without fair compensation for certain types of payphone calls, because such a standard would not permit the PSP to recover a reasonable share of the joint and common costs associated with those calls.

Payphone Order, ¶ 68. In the Reconsideration Order, the Commission elaborated:

> The TELRIC plus common cost standard in the local competition proceeding refers to the long run cost of an element or physical facility. Since there are relatively few common costs between separate facilities, TELRIC compensation will compensate a carrier for virtually all costs associated with providing (the services of) that facility. With the addition of a share of the relatively small common costs, the firm will be able to cover its total costs. In this proceeding commenters argue that we should apply a TSLRIC cost standard to only a subset of services (i.e., subscriber 800 and dial around calls) provided by a facility (payphone). In general when several services are provided by the same facility, the incremental cost of providing any one service is very small and the common cost among these services is very large. Thus, a TSLRIC standard under which a carrier is compensated only for the incremental cost of each service individually without a reasonable allocation of common costs, as suggested by commenters, would not allow the carrier to recover the total costs of providing all of the services. A TSLRIC standard that yields prices that recover a reasonable share of joint and common costs would require the difficult allocation of those (large) costs among the different types of calls made from payphones.

Reconsideration Order, ¶ 69.

Nothing in the court's decision requires -- and nothing in the IXC comments justifies -- resuscitating the keypad-wear-and-tear approach. According to Sprint, the keypad-wear-and-tear approach is appropriate because:

> the Commission could fairly presume that PSPs would not place or keep payphones in service unless they were reasonably assured of recovering the total costs of operating those phones from the types of calls -- local coin calls and 0+ calls -- which would be revenue-generating to them in the absence of Commission-prescribed compensation for other calls.

Sprint at 3.

However, the record flatly contradicts Sprint's claim. The record shows that lack of fair compensation gravely threatens the viability of leading payphone companies. Communications Central Inc. 1996 Reply Comments at 9; Peoples 1996 Comments at 6-7. Therefore, there is no factual basis to "presume" that PSPs are recovering the total costs[8] of their payphones from currently compensated calls. In addition, the record shows that the ability of PSPs to recover their costs from currently compensable calls is deteriorating. 0+ traffic volumes continue to decline as more and more 0+ calls are displaced by dial-around calls. APCC Att. 4 (survey shows payphones average only 24 0+ calls per month, compared with 152 dial-around calls). While an increase in the coin rate is likely to provide some relief, the increased per-call revenue will be offset to some extent by some suppression in demand.[9]

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[8] We assume that by "costs" Sprint means to include a fair return on investment.

[9] The expected falloff in coin call demand was not included in APCC's study of PSPs' per-call costs. Because the fixed costs of payphones would remain about the same, a local coin rate increase that causes suppression in local coin calling demand will result in a

(Footnote continued)

As for LEC payphones, FCC statistics show that the installed base of payphones has steadily declined in the 1990s. Existing compensation levels clearly have not been adequate to promote widespread deployment of payphones by LECs.

Further, even if payphone companies could be profitable in the absence of market-based dial-around compensation, that would not prove Sprint's case for incremental cost compensation. Unless all calls contribute fairly to the recovery of fixed or joint and common costs, there is no fair compensation for "each and every call." Communications Central at 15-17. Instead, the fixed or joint and common costs will be loaded exclusively onto 0+ and coin calls, and those callers will have a persuasive argument that they are paying more than their share.[10]

Further, it is not enough that the current number of payphones has been installed at current compensation levels. The key goal of both Congress and the Commission in this proceeding is to promote widespread deployment of payphone services.

(Footnote continued)
higher per-call cost. The overall effect will depend on demand elasticities. APCC asked its consultant to analyze the effect on per-call costs of 10% and 20% declines in local coin calling demand. The results show that per-call costs would increase from 41 cents per call to 45 (10% decline in demand) or 47 cents per call (20% decline in demand). See Attachment 1. A more conservative assumption about demand elasticity would forecast a reduction of 5% in local coin calling. Based on the attached analysis of 10% and 20% declines, a 5% decline would cause a smaller, but still significant increase in average per-call costs, to about 43 cents per call.

[10] State commissions and other parties to this proceeding have repeatedly expressed concern that coin calling rates should not be unduly increased. As for 0+ calls, the Commission is considering various proposals for limiting the rates charged for 0+ calls. Billed Party Preference for InterLATA 0+ Calls, Second Further Notice of Proposed Rulemaking, 11 FCC Rcd 7274 (1996).

47 U.S.C. § 276(b); Payphone Order, ¶ 48; Reconsideration Order, ¶ 66. Congress would not have declared this to be its objective if it had been satisfied with the current level of deployment of payphone services. Thus, current compensation levels are not sufficient to promote widespread deployment of payphone services.

Finally, there is no merit to Sprint's claim that the current (35 cents) rate of dial-around compensation, or any other market-based rate, would provide a "windfall" to PSPs. As discussed above, current compensation levels are not sufficient to keep PSPs profitable. However, even if they were sufficient, there is no reason to believe that providing dial-around compensation would result in excessive "windfall" profits. Rather, market forces would ensure that total payphone revenues are no higher than necessary to recover costs plus a market return. The court affirmed the Commission's finding that the Payphone Order removes all remaining barriers to full competition in the payphone market. IPTA at 12. In competitive markets, an increase in revenue opportunities will attract new entrants and increase the supply of payphones. With increased supply, competitive pressures will ensure that rates stabilize at levels just sufficient to cover all costs plus a market rate of return. Therefore, with the addition of fair dial-around compensation, local coin rates and other market-determined payphone rates will settle at competitive levels that are proportionately lower than the levels that would be reached in the absence of fair dial-around compensation. The IXCs present no convincing reason why any "windfall" would remain for PSPs after market pressures have done their work on market-determined rates. Any "windfall" will be gained, as it should be, by payphone consumers who will benefit from relatively lower rates on other calls.

3. AT&T's analysis of payphone costs is without merit

AT&T is the primary advocate of not including any costs related to coin functionality or the coin operations of PSPs. Although AT&T no longer styles its cost analysis as a "TSLRIC" or "TELRIC" style cost analysis, it continues to make the same argument that the relatively fixed costs of providing coin calling capability in a payphone may not be recovered, even in part, from dial-around calls. As discussed in APCC's initial comments and above, this argument is without merit.

Moreover, there are several additional flaws in AT&T's analysis. First, taking AT&T's analysis at face value, without correcting for significant non-coin costs AT&T omitted from its analysis and AT&T's understatement of other costs, and eliminating all costs related to coin calls, as AT&T has, when AT&T's analysis is corrected to account for the cost of non-coin calling only, the cost of a non-coin call is $.38. AT&T shows costs of $76.85/month for a coinless payphone. AT&T divides this amount by 700, using APCC's figure of roughly 700 total calls per month from an average payphone, to yield an average per call cost of $.11. But APCC's comments filed on August 26, showed that only about 200 of these calls are coinless calls. APCC, Att. 4. Thus, if a payphone were placed for coinless calls only, the cost per call is $.38 ($76.85 ÷ 200).[11]

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[11] It is of course no answer to using the actual number of coinless calls as the base for calculating the cost of a coinless call to say that the costs actually incurred at a coin payphone are covered by all calls, including coin. That, of course, is APCC's point, that (Footnote continued)

But this is only one of many flaws in AT&T's analysis. AT&T began by picking and choosing those pieces from different analyses that will best make its case. For example, AT&T uses the 10 year useful life of assets suggested by Peoples Telephone Company. Appendix at 5. But AT&T chooses (incorrectly, as pointed out above) APCC's average call volume of 700 calls (Appendix 1 at 12) rather than Peoples' call volume of 635 in order to attempt to drive average call costs down.

Similarly, AT&T chooses to use an "11.25% percent interest of [sic] capital factor because it is a reasonable cost of capital *to AT&T* for this type of equipment." Appendix 1 at 5 (emphasis added). Of course, few independent PSPs can access capital at such a favorable rate, and rates of 15%-18% are more realistic.

AT&T also includes no overhead costs. Peoples Telephone Company showed overhead costs of about 8.25% (Peoples at 10), while Communications Central ("CCI") showed overhead costs of about 11% (CCI at 10).

AT&T also included no commission costs for dial around compensation. As the PSPs unanimously explained, commissions must be paid on dial around compensation.

Making adjustments to AT&T's "bottom-up" model to reflect just these three category of costs -- a more realistic capital return of 15% that raises monthly "Equipment/Installation" from $11.35 to $16.29; including overhead costs of 10%; and including commissions on dial around compensation at 20% ($9.17) -- and dividing by the

(Footnote continued)
the payphone would not be there without the coin calls. Therefore, all common costs of all calls should be borne equally by every call.

number of coinless calls raises AT&T's average cost for a coinless call to $.50.[12] And this result is reached while continuing to indulge AT&T's erroneous assumption that none of the coin associated costs of the payphone can be included in the costs of a coinless call.

But of course, as explained above, all calls should bear the fixed and common costs. Like AT&T's "bottom-up" approach, AT&T's "top-down" approach simply ignores these factors. In AT&T's "top-down" analysis, AT&T attributes 44.9% of the cost of a smart phone to coin related costs. Indulging AT&T's erroneous omissions and understatements -- as in its bottom-up approach, AT&T understates the cost of money, ignores commission payments on dial around compensation, and omits overheads -- this would reduce the $.35 per call compensation to $.1925, or by $.1575. But 8.6% of the 44.9% reduction is directly attributable to common fixed costs (equipment) and another 14.9% is attributable to coin collection costs, which APCC and the independent PSPs have shown are matched by the costs of collecting dial around compensation. See Communications Central at n.12, Peoples Telephone at 13. Thus, fully 23.5% of the alleged cost difference can immediately by restored, leaving a reduction of only 21.4%, or a per call compensation level of $.275. Most of the remaining difference is accounted for by AT&T's dubious assumptions about variations in maintenance and repair costs, warehousing, etc.

Significantly, on the one cost that APCC agrees with AT&T is a cost difference between local coin calls and coinless calls -- local usage -- APCC and AT&T are in

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[12] Total monthly costs rise from $76.85 (AT&T Appendix 1 at 12) to $100.04, divided by 200 coinless calls.

agreement that the cost difference per call is in the $.03-.04 range. AT&T's top-down approach attributes 10.8% of costs to local coin usage, or about $.0378 using the $.35 dial around figure used by the Commission. APCC pegged per call usage at about $.03. Of course, when the correct cost of a call is used, in the range of $.41, APCC at 15, Attachment 3, the compensation per call, taking account of the local usage change, must still be set at $.38.[13]

4. The Commission should not rely on the second-hand NYNEX "cost study"

Seeking plausible evidence of the actual costs of an efficient PSP, the major IXCs all seize upon a certain "cost study" submitted by NYNEX to the Massachusetts

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[13] AT&T also argues that, where PSPs are billed for local service on a flat-rate basis, with no usage charge, "they should be required to disaggregate such charges." AT&T at 10, n. 13. There are two flaws here. First, AT&T assumes that the costs being recovered by the LEC are usage sensitive and "ought" to be recovered on a usage basis. But data in FCC proceedings show that variable usage-sensitive costs of a local call are, at most, 0.55 cents per call minute (or 1.65 cents for a three-minute call). See, e.g., Implementation of the Local Competition Provisions in the Telecommunications Act of 1996, 11 FCC Rcd 15499, 15907, 15910 (1996) (establishing default proxy prices of 0.2-0.4 cents per minute for local switching and 0.15 cents per minute for tandem switching). Therefore, to the extent that local service charges are to be "disaggregated" into their true traffic-sensitive and non-traffic-sensitive components, the same analysis should apply to those local usage charges that are currently priced on a usage-sensitive basis. APCC submits that if all local service charges were properly disaggregated into TS and NTS components, the resulting usage charges would amount to a lot less than the three cents per call estimated in APCC's initial comments.

Furthermore, since those PSPs that are billed on a flat-rate basis currently experience ***their*** costs as flat, it is not necessary or appropriate to insist that these flat rates be disaggregated into their "true" components. Under the correct analytical framework, it is PSPs' costs, not LEC costs, that matter. If the PSPs experience their local network service costs as a flat rate, then those costs are fixed as far as the PSPs are concerned, and should be recovered from all calls.

Department of Public Utilities ("DPU"). AT&T at 12, n.15; MCI at 5, n.4; Sprint at 8-11. The IXCs claim that the NYNEX data should be used under the "bellwether carrier" principle to develop a compensation rate generally applicable to the payphone industry. As discussed below, even assuming that a "bellwether carrier" analysis was otherwise appropriate, the circumstances of NYNEX's cost study clearly disqualify it for such a purpose.

This cost study was submitted by NYNEX in March 1997, in connection with a pending request for a temporary increase in the local coin rate, pending the full deregulation of that rate as of October 1997. NYNEX' predicament was unusual because, unlike the vast majority of LEC PSPs, its local coin rate in Massachusetts had been frozen for years at 10 cents per call, while most other jurisdictions were allowing rates of at least 25 cents per call.

There are numerous problems with the IXCs' claims that this hastily submitted cost study provides a "bellwether" indicator of actual costs of efficient PSPs. First, even under the best of circumstances, LEC cost studies are of limited value, given the numerous uncertainties inherent in the allocation of costs. As the RBOC Coalition notes, "[t]he costs of RBOC PSPs have been skewed by regulatory considerations...." RBOC Coalition at 30.

Second, NYNEX does not appear to have devoted a great deal of care to the preparation of the study, nor was it carefully scrutinized by the DPU. The study was apparently submitted on March 5, 1997, weeks after the initial rate increase request.

Twenty-six days later, the DPU allowed the rate increase. In its written opinion fourteen days later, the DPU stated:

> To determine whether NYNEX's cost analysis is accurate, the Department would need to conduct a full investigation. In all likelihood, such a rate investigation would require the customary six months and would therefore not be completed until September or October 1997, when federal rules require market-based rates to be implemented. Even if this investigation resulted in a finding that a different rate was justified, the Department would then shortly be preempted by federal law from implementing that charge. It would be an imprudent use of regulatory resources, which are ultimately derived from ratepayers, to conduct a resource-intensive investigation of NYNEX's payphone cost study, the results of which would be short-lived given the October 7, 1997 deregulation date.
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> Moreover, NYNEX has proposed, and the Department will require that NYNEX return any payphone subsidy to ratepayers as part of what it calculates to be a $32 million exogenous cost adjustment at the time of its next annual price cap compliance filing, in June, 1997. Equally important, NYNEX has proposed, and the Department also will require that NYNEX calculate the subsidy as of April 1, 1997, so that NYNEX's ratepayers would realize the full amount of the subsidy due them. Therefore, for the reasons cited above, the Department has allowed NYNEX to detariff the coin rate charged by its new PSP.

<u>Investigation by the Department of Public Utilities on its own motion as to the propriety of the rates and charges set forth in the following tariffs: M.D.P.U. Nos. 10 and 15, filed with the Department on December 31, 1996, to become effective January 30, 1997 [Public Access Smartline Service], and M.D.P.U. No. 10 filed January 24, 1997, to become effective February 23, 1997 [elimination of the coin rate for local calls] by New</u>